



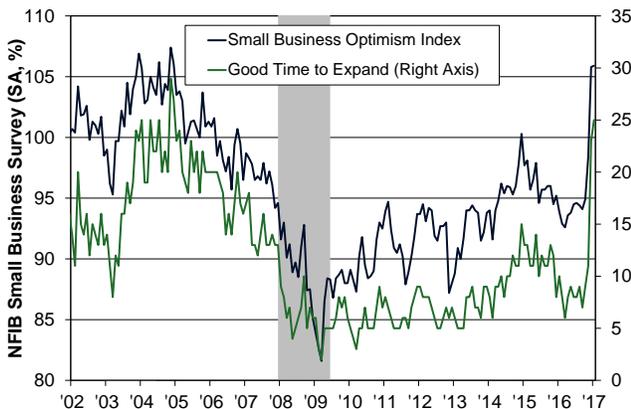
Weekly Note – February 17, 2017

### Economics: Consumer Spending Should Remain Solid

This week's reports offered a glimpse into the health of consumer spending this quarter. While overall retail sales (not adjusted for inflation) weakened in January, core sales—an input used to estimate consumer spending on goods in gross domestic product calculations—posted another solid gain. However, the biggest decline in utility output in 11 years from this week's industrial production report suggests that utility spending likely pulled back sizably in January, which should weigh on service spending during the month. On the inflation front, both retail and wholesale inflation picked up in January; as such the increase in real core sales will not be as impressive as the nominal gain. Overall, we expect real consumer spending growth in the current quarter to hold close to last quarter's 2.5 percent annualized pace and to remain the biggest driver of growth. In other news from this week's industrial production report, a surge in mining output in January bodes well for business investment in structures this quarter, confirming that the drag from declining crude prices on drilling activity and crude oil production is likely behind us. Meanwhile, manufacturing output was up for the fourth time in five months, in line with other recent factory-related data, suggesting that activity in the sector will improve this year as the drag from the 2014-2015 surge in the dollar fades and global demand strengthens. Small business owners remained optimistic in January, with the net share of firms reporting that now is a good time to expand rising to the highest reading since 2004. Lastly, in her semiannual testimony to Congress, Fed Chair Janet Yellen noted that "at our upcoming meetings, the [Federal Open Market] Committee will evaluate whether employment and inflation are continuing to evolve in line with these expectations, in which case a further adjustment of the federal funds rate would likely be appropriate." She reiterated that changes in fiscal and other policies are among the sources of uncertainty and that a gradual pace of monetary normalization is appropriate. Our call remains that the next rate hike will not occur until the June meeting.

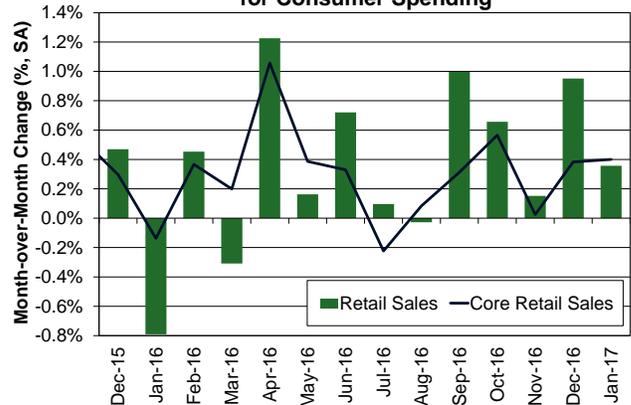
- **Retail sales** rose 0.4 percent in January on a seasonally-adjusted basis, according to the Census Bureau. Sales at gasoline stations increased, while sales at auto dealers dropped. Furniture sales and internet sales were flat, while sales at electronics and appliance stores were strong. Core sales (excluding autos, gasoline, and building materials) also rose 0.4 percent.
- **The Consumer Price Index (CPI)** rose 0.6 percent in January, driven by the biggest monthly rise in gasoline prices in about four years. Excluding food and energy items, core prices were up 0.3 percent, largely boosted by apparel and new vehicle prices. The annual changes in the overall and core CPI firmed to 2.5 percent and 2.3 percent, respectively. **The Producer Price Index (PPI)** for final demand of goods and services rose 0.6 percent in January. Core prices rose 0.4 percent from the prior month and 1.2 percent from last January. (The Bureau of Labor Statistics produces both reports).
- **Industrial production**, a gauge of output in the manufacturing, utility, and mining sectors, fell 0.3 percent in January, according to the Federal Reserve Board. A weather-related decrease in utility output of 5.7 percent drove the overall decline in output. Manufacturing output rose 0.2 percent. Mining output rose 2.8 percent, as both oil and gas drilling and oil and gas extraction rebounded.
- **The National Federation of Independent Business (NFIB) Small Business Optimism Index** edged up one-tenth in January to 105.9, the highest level since December 2004. Small business confidence has risen 11.6 percent over the past three months, boosted by a surge in the net share of businesses who say that it is a good time to expand over the next three months, which has almost tripled since October to an expansion high of 25 percent.

Small Businesses Are Hopeful to Expand



Source: National Federation of Independent Business

Overall Sales Slow but Core Sales Bode Well for Consumer Spending



Source: Census Bureau

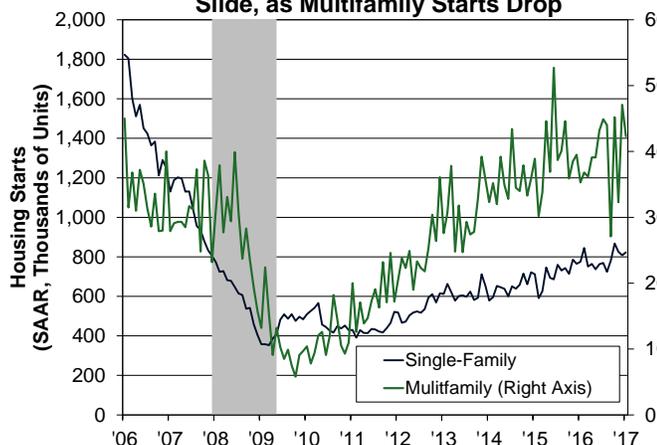


## Housing: Builders' Confidence & Mortgage Demand Slip

Data released this week offered mixed news on construction activity at the start of 2017 and on mortgage performance at the end of 2016. Total home construction fell in January for the second time in three months after reaching an expansion best in October 2016, as the volatile multifamily component gave back a significant portion of the large gain in December. Single-family starts posted a modest increase to end a two-month slide. Single-family permits, on the other hand, fell for the first time in six months from an expansion best in December. Thanks to a rise in multifamily permits, total permits advanced to a 14-month high. Home builders' confidence in the new single-family home market slipped in February, falling for the second consecutive month from the 11-year high reached in December. All three subcomponents—current sales, sales expectations, and foot traffic of potential buyers—declined during the month, though they remain at elevated levels. Shifting to mortgage performance, the Mortgage Bankers Association reported that the overall delinquency rate rose last quarter for the first time since the first quarter of 2013, while the serious delinquency rate increased for the first time since the third quarter of 2011. However, the foreclosure start rate, which is closely linked to labor market conditions, fell for the eighth consecutive quarter to hit a 28-year low. Mortgage demand slipped last week for the second time in the past three weeks, as both purchase and refinancing loan applications declined. Purchase applications dropped to a three-month low, and refinancing applications fell to the lowest level since the first week of January. Mortgage rates, however, continued to trend down this week from the more than two-year high reached in the final week of December 2016, falling two basis points to 4.15 percent, according to Freddie Mac's survey.

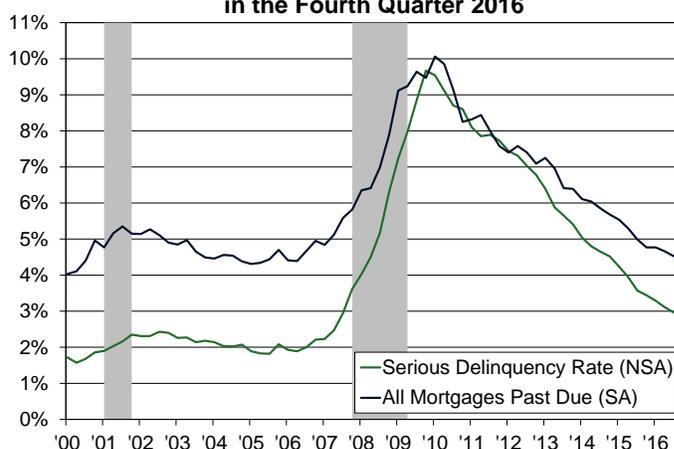
- **Housing starts** declined 2.6 percent to 1.25 million annualized units in January, according to the Census Bureau. Multifamily starts fell 10.2 percent to 423,000, while single-family starts edged up 1.9 percent to 823,000. New residential building permits improved 4.6 percent to 1.29 million annualized units. Single-family permits fell 2.7 percent to 808,000, but multifamily permits rose 19.8 percent to 477,000.
- **The Mortgage Bankers Association National Delinquency Survey** for Q4 2016 showed that the delinquency rate for mortgage loans on one-to-four unit residential properties increased 28 basis points to a seasonally-adjusted rate of 4.80 percent of all loans outstanding. The percentage of loans on which foreclosure actions were started edged down three basis points to 0.27 percent. The survey showed that the serious delinquency rate (the percentage of loans that are 90 days or more past due or in the process of foreclosure, not seasonally-adjusted) rose 17 basis points to 3.13 percent, 31 basis points below the level in Q4 2015.
- **The National Association of Home Builders/Wells Fargo Housing Market Index** fell two points to 65 in February. A reading of more than 50 indicates that more builders view housing market conditions as good rather than poor. The present sales component slipped one point, sales expectations over the next six months fell three points, and foot traffic of potential buyers dropped five points.
- **Mortgage applications** declined 3.7 percent for the week ending February 10, according to the Mortgage Bankers Association. Purchase applications decreased 4.5 percent, while refinancing applications decreased 2.9 percent. Applications fell even as the average 30-year fixed mortgage rate declined three basis points to 4.32 percent.

**Single-Family Starts Rise, Ending a Two-Month Slide, as Multifamily Starts Drop**



Source: Census Bureau

**Mortgage Delinquency Rates Rise in the Fourth Quarter 2016**



Source: Mortgage Bankers Association.

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